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IN THE MATTER OF THE ARIZONA
CORPORATION COMMISSION'S
INVESTIGATION OF REGULATORY AND
RATE INCENTIVES FOR GAS AND
ELECTRIC UTILITIES

Docket No. E-00000J-08-0314
G-00000C-08-0314

SWEEP COMMENTS ON THE
DRAFT POLICY STATEMENT

**COMMENTS OF THE SOUTHWEST ENERGY EFFICIENCY PROJECT (SWEEP)
ON THE DRAFT POLICY STATEMENT REGARDING UTILITY DISINCENTIVES
TO ENERGY EFFICIENCY AND DECOUPLED RATE STRUCTURES**

The Southwest Energy Efficiency Project (SWEEP) appreciates the opportunity to submit comments on the Draft ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures dated October 18, 2010. SWEEP participated in the Commission workshops on utility disincentives and decoupling, and the body of the Policy Statement accurately summarizes the analysis presented in the workshops and the workshop discussions. SWEEP strongly supports the Draft Policy Statement and provides its comments below.

1. Increasing energy efficiency as required by the Commission's Electric Energy Efficiency Standard (22% energy savings by 2020) and Gas Energy Efficiency Standard (6% energy savings by 2020) is in the public interest and will result in lower utility bills.

Increasing energy efficiency as set forth in the Electric and Gas Energy Efficiency Rules is in the public interest because doing so will provide significant, cost-effective benefits to Arizona utility ratepayers (residential consumers and businesses), the electric and gas utility systems, the economy, and the environment. Increasing cost-effective energy efficiency will save money for consumers and businesses through lower utility bills, resulting in lower total utility costs for ratepayers. Increasing energy efficiency will also diversify energy resources, mitigate risks, reduce air pollution and emissions, and create jobs and improve the Arizona economy.

The independent analysis of Lawrence Berkeley National Laboratory (LBNL) presented during the workshops estimated that APS and TEP customers would experience utility bill savings of \$8.7 billion in 2011-2030 under the Energy Efficiency Standard relative to a scenario of no energy efficiency, and \$5.2 billion relative to a scenario in which the utilities achieved about 1% annual energy savings. These are huge utility bill savings for Arizona consumers and businesses.

1
2 SWEEP has reviewed the most recent APS and TEP resource plans available to the public, which
3 were developed largely before the Commission approved the Electric and Gas Energy Efficiency
4 Rules and Standards. Based on its review, SWEEP estimates that significant deferrals of major
5 generation plants and other investments will result from the achievement of the energy savings
6 required by the Energy Efficiency Standard, resulting in much lower utility bills for customers
7 and other benefits for Arizona. For example, SWEEP estimates that the large baseload plants
8 identified in the APS resource plan as being needed in the early 2020's will now be able to be
9 deferred until about 2030 with the Energy Efficiency Standard. Such plant deferrals, including
10 deferrals of baseload and peaking plants, should be identified by the utilities in response to the
11 questions in the October 18, 2010 cover letter from Chairman Mayes.

12
13 **2. The significant energy savings resulting from the electric and gas Energy Efficiency**
14 **Standards, combined with other Commission policies, call for revisions in the**
15 **regulatory treatment of utilities and a new utility business model.**
16

17 The significant energy savings resulting from the electric and gas Energy Efficiency Standards
18 will result in major changes in the way Arizona customers meet their energy resource needs. For
19 example, the energy savings from the electric Energy Efficiency Standard will result in an
20 electric resource pie chart in 2020 with energy efficiency contributing about 20% of the total
21 energy resources needed to meet customer needs. Fully one-fifth of the energy resource "pie" in
22 2020 will be provided by customer energy efficiency. The regulatory treatment of utilities needs
23 to be revised to support these significant and beneficial changes for customers.

24
25 In parallel, the utilities should be developing a new business model, one that is focused on
26 serving customers and meeting their energy resource needs, including through significant
27 increases in energy efficiency and renewable energy, while keeping customer energy bills low –
28 rather than the business model of the past, which was based on selling more energy to customers.

29
30 **3. In order to achieve the customer bill savings and other benefits from increased energy**
31 **efficiency, the financial incentives of the utilities should be aligned with the interests of**
32 **customers and the public. Revenue decoupling is an important step to remove the**
33 **utility financial disincentive to increased energy efficiency.**
34

35 Under traditional regulation, when utility revenues are based on energy sales throughput, the
36 financial incentives of utilities and the interests of customers are *not* aligned – in fact, they are in
37 conflict. With traditional regulation, utilities are incented to increase energy sales to customers
38 and discourage energy efficiency. When customers save energy and reduce their utility bills,
39 utilities lose revenue and do not fully recover their fixed costs.

40
41 Decoupling removes or "decouples" the link between energy sales (customer usage) and utility
42 revenues, thereby removing the utility financial disincentive to higher energy efficiency.

1
2 **4. Decoupling removes a utility financial disincentive, but it is not a positive financial**
3 **incentive. Therefore, decoupling should be developed and implemented as one part of a**
4 **three-part regulatory framework to support customer energy efficiency and to align the**
5 **utility financial incentives with the interests of customers.**
6

7 The three-part regulatory treatment to encourage increased energy efficiency should include:

- 8 • Timely recovery of prudent costs (cost-recovery);
9 • Removal of the financial disincentive that results from utility revenues being linked or
10 “coupled” to customer energy usage and sales (decoupling); and
11 • An opportunity to earn a positive performance-based incentive for achieving
12 Commission-approved goals (performance incentives).
13

14 The Commission has approved the first and third parts of the above framework, and adoption of
15 the Policy Statement would mean a significant step forward in addressing the second part.
16

17 **5. The Draft Policy Statement is well-founded and is supported by the analysis and**
18 **discussions in the Commission workshops. SWEEP supports the Draft Policy**
19 **Statement including the Issues discussion and the Policy Statements in the document.**
20

21 SWEEP supports the Issues discussion and the Policy Statements in the Draft Policy Statement,
22 including:

- 23 • Utilities should pursue all cost-effective energy efficiency and DSM resources, and
24 should meet Arizona’s Electric and Gas Energy Efficiency Standards of at least 22%
25 electric energy savings and 6% gas savings by 2020 (p. 30);
26 • It is crucial to address utility financial disincentives to the pursuit of energy efficiency (p.
27 27-28);
28 • The adoption of specific decoupling mechanisms should happen in rate cases, with
29 evaluation and review after an initial three-year period (p. 28);
30 • The adoption of decoupling should not occur on a pilot basis, as pilot adoption would not
31 send appropriate signals and would not demonstrate the requisite commitment to
32 eliminating utility financial disincentives to the adoption of energy efficiency (p. 28-29,
33 and 30);
34 • A preference for revenue decoupling, which offers significant advantages over other
35 mechanisms (p 30), and the concerns raised regarding fixed cost/variable pricing and lost
36 margin recovery mechanisms (p. 28);
37 • Deferral of cost of capital issues to a time when there is more experience with decoupling
38 in Arizona, specifically until after the initial three-year period (p. 31);
39 • Revenue per customer decoupling is well suited for Arizona (p. 30);
40 • A preference for full decoupling (p. 29 and 31);

- Discouraging weather normalization in the application of decoupling because weather normalization would reduce the size of decoupling adjustments (credits to customers) follow extreme weather events (p. 31);
- Support for timely and more current decoupling adjustments, where feasible (p. 29 and 31);
- Blending of the decoupling adjustments across customer classes to reduce any significant fluctuations experienced by any one customer class (p. 31);
- Broad participation in decoupling by all customer classes is preferred, while allowing for proposals for distinct treatment with justification for why certain customer classes or segments may merit different treatment (p. 31);
- Decoupling adjustments and customer rate designs to encourage energy efficiency are preferred (p. 31); and
- Collars or caps on decoupling adjustments to encourage gradualism and to limit any dramatic changes in customer rates (p. 31). SWEEP agrees that caps on decoupling surcharges are essential. However, customers should receive the full amount of any refund in a timely manner in the event that achieved revenue per customer exceeds authorized revenue per customer, and therefore the decoupling adjustments that are credits or refunds to customers should not be capped.

SWEEP supports the Draft Policy Statement as proposed, with the exception of a few passages for which SWEEP believes wording clarifications may be useful. SWEEP plans to review the comments of other parties and submit supplemental comments on such specific wording clarifications in the two dockets by no later than Monday, November 1, 2010.

6. By adopting the Policy Statement, the Commission would take an important step forward by permitting utilities to file proposals for decoupling and by providing policy statements and guidelines for the development for such proposals. However, the Commission does not approve decoupling by adopting the Policy Statement; such review and approval of decoupling and specific decoupling mechanisms is reserved for the rate case proceedings.

SWEEP believes it is appropriate for the Commission to provide policy statements to guide utility development of decoupling proposals through the Policy Statement, while reserving Commission review and approval of the specific decoupling proposals for the rate case proceedings.

7. SWEEP recommends that the Commission consider several important policy objectives and issues when considering the Draft Policy Statement and during its future reviews of decoupling proposals.

Specifically, SWEEP recommends:

- The focus of Commission deliberations and actions should be on reducing energy bills and achieving benefits for customers.
- It is not necessary or appropriate to address unrecovered fixed costs associated with energy efficiency unless there are significant utility efforts to support energy efficiency, which SWEEP defines as annual electric energy savings of at least 1% of retail energy sales. SWEEP acknowledges that the Commission-adopted Energy Efficiency Standards require very significant efforts by the electric and gas utilities, and therefore SWEEP supports Commission consideration of decoupling at this time. However, should utility commitment to energy efficiency or utility efforts in support of energy efficiency programs wane for any reason, SWEEP would then recommend that decoupling be discontinued.
- The Commission should also consider, in future rate cases, revisions to ratemaking treatment such as adjustments to test years or adjustments to the sales and revenue forecasts in rate cases to make such test years or forecasts consistent with Commission policies and the forecasted effects of the policies, including the forecasted energy savings due to the Energy Efficiency Standards.
- In future rate cases, utilities should be required to demonstrate plant deferrals and reductions in costs (relative to a base case without the Energy Efficiency Standards) so that there are fewer costs to recover from customers. Load reductions of about 20% (electric) and 6% (gas) in 2020 should reduce currently-planned utility costs significantly, and such reductions in forecasted costs should be demonstrated in future rate cases.

8. SWEEP urges the Commission to adopt the Draft Policy Statement to support the Commission's prior actions to increase customer energy efficiency, and to support the achievement of the electric and gas Energy Efficiency Standards, which will result in lower utility bills for Arizona customers.

Thank you for the opportunity to submit these comments on the Draft ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures.